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IN THE

Supreme Court of the United States

October Term, 1955

No. 403

PAUL FREEDMAN,

Petitioner,

vs.

DONOVAN & SCHUENKE, HORACE F. FRENCH, RALPH A. McCLURE and A. E. FRENCH,

Respondents.

Respondents' Brief in Opposition to Petition for Writ of Certiorari.

Introductory Comment.

Primarily we wish to note that petitioner's "Statement of the Case" is inaccurate, deficient and needs revision and correction. It skirts the pertinent and material facts and presents a faulty appraisal of the record.

In contrast to petitioner's purported statement of the case, the respondents' counter statement hereinafter set out is based upon the essential and material facts disclosed by the record, some of which were mentioned by the United States Court of Appeals as having a material bearing in a proper determination of the issues involved.

Briefly stated, this case involves an asportation of bankruptcy assets by a fiduciary, D. J. Miller, who was aided and abetted by petitioner herein. In fact, the fiduciary, Miller, could not have accomplished his fraudulent scheme without the financial aid and active participation of petitioner.

Contrary to the petitioner's contention, the record in this case shows an abortive purchase made by the petitioner in fraud of the creditors of the bankruptcy estate, and in total disregard of the well settled legal and equitable principles applicable to sales of bankruptcy assets.

Petitioner Has No Standing to Present a Petition for a Writ of Certiorari.

The petitioner here for a writ of certiorari, although named as a respondent in the proceedings before the Referee and upon review in the District Court, and as an appellee in the United States Court of Appeals, filed no brief upon review or upon appeal and made no appearance in either of said Courts, but permitted his interests to rest upon the showing made by the trustee, and thereby has no standing to present a petition for writ of certiorari. (See opinion of the United States Court of Appeals denying petitioner's petition for rehearing upon this and other grounds. Appendix "C", pages 18-19, Petition for Writ of Certiorari.) It is obvious that neither the trustee nor D. J. Miller is seeking a writ of certiorari.

Jurisdiction.

Petitioner has failed to show a good reason under Rule 19 of the Rules of this Honorable Court why this Court should assume jurisdiction. There is no conflict of opinion in the Courts of Appeals upon this question and this

Honorable Court has passed upon similar questions adversely to petitioner's contention in *Mosser v. Darrow*, 341 U. S. 267, 271; *Jackson v. Smith*, 254 U. S. 586, 589; *Michand v. Girod*, 45 U. S. 501. See also: *In re Frasin v. Oppenheimer*, 2 Cir., 181 Fed. 307; *In re Stephens & Co.*, D. C., 30 F. 2d 725, 726; *In re Van Sweringen Company*, 119 F. 2d 231. Note particularly the forceful expressions of Justice Cardozo upon the question here involved in the case of *Meinhard v. Solmon*, 249 N. Y. 458, 464; 164 N. E. 545, 546; 62 A. L. R. 1, and quoted in the *Van Sweringen Company* case above cited.

State Statutes Involved.

The Statutes and Case Law of California applicable to the questions involved are set forth in the appendix.

Counter Statement of the Case and Facts.[1]

The Ridgecrest Development Company, a corporation, was adjudicated a bankrupt on or about May 12, 1947. The order of reference was to Referee Waldo R. Bergman, who was subsequently succeeded by Referee William A. McGugin. The bankrupt corporation owned, among other properties, a large and valuable tract of land at Ridgecrest, California, which was partly developed.[2]

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[1]An explanation of the record is in order. The Court reporter, in transcribing the evidence, included certain evidence received by the Referee on the same day in relation to objections to claims. The hearing and evidence in relation to the Order to Show Cause why the order confirming sale should not be set aside begins at page 113 of the Record.

[2]Ridgecrest is in Kern County, in the Mojave Desert, near a large naval training base. This desert area has undergone extensive development since World War II.

Paul W. Sampsell was appointed trustee of this estate on or about June 21, 1947, and has continued to act as such. D. J. Miller was the president of the bankrupt. L. E. Seversen was its vice-president, and L. M. Vreeland its secretary. [See Find. No. III, R. p. 55.]

The trustee attempted to make a sale of the assets of this bankrupt estate upon five different dates before the sale was confirmed to D. J. Miller in January, 1950 [see Find. No. IV, R. p. 55] and each of these attempted sales was vigorously opposed by D. J. Miller [R. p. 128] and the other officers of the bankrupt, L. E. Seversen and L. M. Vreeland. [See Find. No. V, R. pp. 55-56.]

The protests were so vigorous that Miller, in the name of the bankrupt corporation, filed a review of the order of the Referee, under date of May 4, 1948, confirming a sale to one Nathan King for $136,500.00, *Miller contending that the property was worth $200,000.00.* [See Find. No. V, R. p. 55, and testimony of Paul W. Sampsell, R. p. 128. See also affidavit of Miller in evidence as Pet. Ex. 4, R. pp. 124-125.]

The Referee, upon the *ex parte* application of D. J. Miller, signed an order on September 9, 1949, appointing Miller the exclusive agent of the trustee for the purpose, among others, of selling the property in question [R. pp. 49-50], and providing for a salary to Miller of $100.00 per month. Miller petitioned for the payment of his salary and it was ordered paid. [R. p. 85.] The United States Court of Appeals says in its opinion: "He was paid compensation for his services in this regard." This order was in an immaterial aspect modified by the order of November 2, 1949. [R. pp. 51-52.] This later order was in effect on the date of the order confirming the sale of the property to Miller.

Although Miller was paid a salary for the purpose, among others, of selling the property, he produced no purchaser other than himself. It should be noted that although Paul Freedman was interested in acquiring the property, he did not bid at the bankruptcy sale.

Miller agreed to sell the property to Freedman and Freedman agreed to purchase from Miller, and an escrow was entered into between Miller and Freedman before the sale was confirmed to Miller. [R. pp. 146-155, incl.] [See also Find. No. XIV, R. pp. 59-60.]

On January 13, 1950, the property again was offered for sale and Miller was the successful bidder for the sum of $131,000.00. After the sale was confirmed to Miller, he was not required to pay the purchase price over to the trustee until he had collected the money from Freedman some seven months later. [Find. No. X, R. pp. 57-58.] In this respect he was given consideration which no other prospective purchaser could have obtained.

Although Freedman had originally agreed to pay only $50,000.00 cash to Miller, he subsequently aided Miller in making the cash payments to the trustee by advancing to Miller $100,000.00 in cash [R. p. 154] and permitted the property which he traded to Miller to be encumbered in order to raise the balance of the purchase price for the trustee. Even counsel for petitioner assisted Miller in raising this money. [Find. No. XVI, R. p. 61.] While Freedman admittedly had knowledge that this was a bankruptcy sale and a bankruptcy asset, he refrained from bidding at the bankruptcy sale.

Seversen wrote a letter to the Referee on November 17, 1947, urging that Miller be retained to look after the Ridgecrest properties. Seversen also aided and assisted

Miller in raising the money to cover his bid. These facts are mentioned by the United States Court of Appeals as material facts. (See Opinion, U. S. Court of Appeals.)

The undisputed evidence shows that Miller did receive a substantial profit, the representations of counsel for the petitioner to the contrary notwithstanding. [See testimony of Mr. Mikiel, R. p. 167; also Find. of Referee No. XV, R. pp. 60-61.] Mr. Freedman gave Miller a total of $100,000.00 cash [R. p. 154] plus three properties described in the record and findings, which the Referee found to be of a value of $39,000.00. The difference between the $139,000.00 and the price paid to Miller represents a profit, although we contend the profits exceeded this amount.

Another important and glaring error in the Referee's findings will be noticed from a comparison of Finding XV [R. pp. 60-61] with the only evidence on the subject. In this finding the Referee finds the value of parcel 1 is the sum of $14,000.00. The only witness upon the question of values testified it had a value of "between $15,000 and $16,000." [R. p. 174.] In his finding as to parcel 2, the value fixed by the Referee is $17,500.00. The Witness testified it had a value of "$18,000 to $20,000." [R. pp. 172-173.] Finding as to parcel 3 fixes the value of $7,500.00. The witness testified it had a value of "from $8500 to $10,000." [R. p. 170.] The Referee's findings show a total value of $39,000.00. The testimony of the witness shows a minimum value of $41,500.00, and a maximum value of $46,000.00. Thus Miller received in value from $141,500.00 to $146,000.00 for the property for which he turned over to the Bankruptcy Court $131,000.00, thereby realizing a profit of from $10,-

500.00 to $15,000.00 without the use of one cent of his own money. The deed from Miller and wife to Freedman, dated February 8, 1950 (fourteen days after the trustee's deed was dated and before Miller paid the trustee the sales price) shows cancelled Internal Revenue stamps of $192.-50, representing the sales price of $175,000.00 or a profit to Miller of $44,000.00. (The Court of Appeals had before it a photostat of this deed which was attached to the petition of the Bank of America for permission to file a brief as *Amicus Curiae* in support of a petition for rehearing.) It is important to keep in mind also that he stalled the Bankruptcy Court along for seven months without paying for the property, and finally paid for same with funds received from Freedman and with funds borrowed upon the strength of the security of the real property he received from Freedman.

Although the Court of Appeals did not disturb the Referee's finding No. XV, such action by the Court of Appeals was unnecessary in view of its finding that the sale to Miller was void. The values of these properties would become important if and when Miller is called upon to account for the illegal profits made by him in this transaction.

Paul Freedman was still the record owner when respondents here filed their petition on September 17, 1950, to set aside the sale to Miller, and Freedman made no contention to the contrary at the hearing before the Referee. Therefore, there were no intervening rights of alleged bona fide purchasers as suggested by counsel for petitioner in point three, page 3 of his petition.

May we also point out that the statement in footnote number 3, page 11, petition for writ, is not supported by the record.

Photostats of all deeds herein were attached to the petition of the Bank of America for leave to file brief as *Amicus Curiae* in support of Freedman's petition for rehearing in the Court of Appeals. All of these deeds disclosed the amount of United States Internal Revenue Stamps attached thereto indicating the purchase price in each case. Also the date of transfer in each instance.

Upon learning in September, 1950, of the order of Court appointing Miller as the agent of the trustee, appellants, on September 17, 1950, filed their petition herein [R. pp. 15-24] seeking to set aside the sale to Miller and for other equitable relief, basing their claim, among other things, on the fact that the sale was void under Section 154 of Title 18, U. S. C. A. Chapter IX. [Pet. Par. X, R. p. 19.] An order to show cause and a temporary restraining order was issued. The trustee filed an answer thereto in which essential facts were admitted. [R. pp. 25-49.] The property at this time still stood in the name of Mr. Freedman.

The matter came on for hearing on October 9, 1950, and was concluded on October 20, 1950, and the Referee made his findings of fact, conclusions of law and an order denying the relief sought in the petition [R. pp. 53-68], from which order a petition for review was filed. [R. pp. 69-76.] The District Judge on March 12, 1952, affirmed the Referee's order [R. pp. 77-78] from which order an appeal was taken. The Court of Appeals reversed the order of the District Court, decreeing the sale to be fraudulent and void.

The Controlling Findings of Fact and Conclusions of Law of the Referee, Which Were Contrary to Our Contention, Were Rejected by the Court of Appeals as Not Being Sustained by the Record.

Petitioner contends that the Court of Appeals (Pet. for Cert., p. 6) left undisturbed the Findings of Fact and Conclusions of Law of the Referee.

The Court of Appeals, in its opinion, says:

> "Irrespective of the cryptic finding, Miller did not cease to be the agent of the Trustee with respect to this very property. The recitals of fact show he was an agent and thus a fiduciary for hire of the Trustee and Referee to deal in the same property which was sold to him. It would be a contradiction of the record for this Court to hold that Miller was not an agent of the Referee and Trustee under an appointment in effect at the time of the sale to him. This is not a question of fact, but a question of law upon the written documents and other uncontroverted facts recited by the Referee in his findings."

The Court further says:

> "It may be objected that Miller is thus brought within the policy of a statute which does not in name include him. But the only purpose of this quotation is to show that the Referee and the Trustee could not have performed these acts themselves. Therefore, they would also be liable, irrespective of good faith, if they permitted one of their sub-agents or employees to do any act which they themselves could not do. This is directly decided in the case of *Mosser v. Darrow*, 341 U. S. 267, 271-272. . . .
>
> "Ordinarily, the findings of a Referee, affirmed by a District Court, as this one was, should be respected by the appellate courts. However, the facts show

that Miller, a former officer of the bankrupt corporation, acted as a fiduciary with respect to this particular property. He was paid compensation for his services in that regard. Under the circumstances, a sale to him cannot be upheld."

The Court of Appeals also says:

"On September 17, the present appellants, *who were creditors of bankrupt,* petitioned the Referee to set aside the sale on the ground that it was void." (Emphasis ours.)

This last quotation would seem to put at rest the question of whether or not appellants before the Court of Appeals were creditors.

It is well settled that a finding is clearly erroneous under Rule 52(a) when, although there is evidence to support it, the reviewing Court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.

United States v U. S. Gypsum Co., et al., 333 U. S. 364;

Grace Bros. v. Commissioner of Internal Rev. (9th Cir.), 173 F. 2d 170.

Questions Presented.

The questions presented by the record are incorrectly stated in the petition for a writ of certiorari. The important questions are:

1. May D. J. Miller, who was the Court's authorized and paid employee of the trustee in bankruptcy, become a purchaser of the assets of such bankruptcy estate?

2. Is such an employee, being a fiduciary both by virtue of his Court appointment and as an officer of the Court,

and as an officer and director of the insolvent bankrupt corporation, required to account to the bankruptcy estate for any profits realized through his purchase of the assets of such bankruptcy estate?

3. Did the petitioner, Paul Freedman, aid and abet and actively participate in Miller's acquisition of the estate's assets in fraud of the creditors and stockholders of the estate?

4. Is Freedman a bona fide purchaser?

5. Was the order of the Referee confirming the sale void, and if so, may it be set aside after the time for a review of the order confirming the void sale had expired?

Argument.

Miller was an officer of the Court, an employee of the trustee and a fiduciary. As such, he could not validly acquire the property of the trust, and the attempted sale to him is void.

It is too clear for argument that D. J. Miller became an officer of the Court by virtue of the Court's own order appointing him, and that he was likewise an employee and agent of the trustee, and remained such until after the order confirming the sale to him had been made.

While the Court of Appeals, in its opinion, refused to become involved over the question of whether or not a criminal statute had been violated, yet it bears repeating that the Court did say, after quoting from a finding of the Referee, that Miller:

> "was an agent and thus a fiduciary for hire of the Trustee and Referee to deal in the same property which was sold to him. It would be a contradiction of

the record for this Court to hold that Miller was not an agent of the Referee and Trustee under an appointment in effect at the time of the sale to him. This is not a question of fact, but a question of law upon the written documents and other uncontroverted facts recited by the Referee in his findings"

and again the Court says:

"It may be objected that Miller is thus brought within the policy of a statute which does not in name include him. But the only purpose of this quotation is to show that the Referee and the Trustee could not have performed these acts themselves. Therefore, they would also be liable, irrespective of good faith, if they permitted one of their sub-agents or employees to do any act which they themselves could not do. This is directly decided in the case of *Mosser v. Darrow,* 341 U. S. 267, 271-272."

While the Court of Appeals says, just before the above quotation, "The record does not show that he (Miller) demanded or was paid the stipulated salary of $100.00 per month," yet earlier in its opinion the Court says: "Miller filed a petition January 26, 1948, for compensation for services to the estate from June 6, 1947, to January 6, 1948, at $100.00 per month, and the next day the Referee authorized payment of $700.00 to Miller on account thereof" and in the last paragraph of its opinion the Court says: "He was paid compensation for his services in that regard." The first quotation was therefore obviously in error. [R. p. 85.]

The cases herein cited under the heading "JURISDICTION" all support the opinion of the United States Court of Appeals and we have looked diligently for decisions to the contrary and have found none.

Miller Cannot Legally Retain Any Profit, Large or Small, Resulting in the Purchase by Him of This Property, and the Bankruptcy Court May Require Him to Account to the Estate and Stockholders of the Corporation for Any Profit Realized.

In addition to the relief sought in the petition to have the sale set aside as void, the petition prays for an accounting to the Court for any profits realized.

The Court calls attention to four violations of their (Miller, Severseen and Vreeland) trust obligations as officers and fiduciaries of the corporation and its assets, the second one being "Refusing to hold the property purchased for the corporation, its stockholders and creditors." Miller is no more entitled to a profit from the sale of the property than is the trustee in bankruptcy.

The Referee, in preparing his certificate on review, and in his zealous efforts to uphold his order, said:

> "That it is the opinion and conclusion of myself as referee that the sale at all times was to Mr. Freedman and that D. J. Miller merely acted as an intermediary between the trustee and the said purchaser;" [R. p. 13]

and counsel for petitioner mentions and obviously stresses this statement.

If it were true that the sale at all times was to Freedman and that Miller merely acted as an intermediary between the trustee and Freedman, then why was it that the property traded by Freedman to Miller was not transferred to the trustee instead of permitting Miller to speculate with it to the detriment of the estate? Assuming there was no actual profit to Miller, the seven months delay in paying the trustee the sales price was a distinct detriment to creditors, even if the sale had been otherwise valid.

Although the Court Held That the Evidence Does Not Warrant a Finding of a Conspiracy as Charged, Yet There Is an Abundance of Undisputed Evidence to Show That Freedman Aided and Abetted Miller in His Fraudulent Scheme, and the Court of Appeals so Found.

The Court of Appeals has called attention to certain evidence which supports the above view. In its opinion denying Freedman's petition for a rehearing, the Court said:

> "It appearing to the Court that appellee Paul Freedman was found by the Court not to have been an innocent purchaser, but having been *an active participant in an official bankruptcy sale,* which was void of record because of the *participation of officers of the Court* in conjunction with Paul Freedman in the purported purchase of property in the custody of the Bankruptcy Court; and . . ." (Emphasis added.)

No doubt the Court had in mind the fact that Paul Freedman went far beyond the terms of his original contract in advancing Miller $100,000.00 cash to complete the sale [R. p. 154], instead of the $50,000.00 which he at first agreed to pay, as one of his participating acts in aiding an officer of the Court to acquire the property of the bankruptcy estate.

Another is the fact that he did not become an active bidder at the bankruptcy sale in opposition to Miller at a time when he was interested in acquiring the property.

Freedman clearly was not an innocent or bona fide purchaser and the Court of Appeals has so found from the

evidence. It is clear that the Court of Appeals has disagreed with the Referee's findings wherever they conflicted with the record supporting the allegations in the petition to set aside the void sale, excepting only the conspiracy allegation. The facts found by the Court of Appeals from the evidence and as related by it would, it seems to us, border close on the conspiracy alleged by the respondents.

The Court of Appeals (8th Cir.) in *Lawrence Warehouse Co. v. Twohig,* 224 F. 2d 493, at 498, said:

> "'A third person who has colluded with a fiduciary in committing a breach of duty, and who obtained a benefit therefrom, is under a duty of restitution to the beneficiary,' Restatement, Restitution, § 138(2). Or, as Professor Scott puts it—'Where a person in a fiduciary relation to another violates his duty as fiduciary, a third party who participates in the violation of duty is liable to the beneficiary. If the third person makes a profit through such participation, he is chargeable as constructive trustee of the profit so made.' 3 Scott on Trusts § 506.
>
> "The term 'benefit', for purposes of restitution, denotes any form of advantage received, which is capable of having its value measured, and it accordingly includes the advantage of being saved from an expense or loss. Restatement, Restitution, § 1, Comment b. Any benefit received by one person as against another is entitled to be regarded as an unjust enrichment, 'if the circumstanees of its receipt or retention are such that, as between the two persons, it is unjust for him to retain it.' *Id.* § 1, Comment c."

The Order of the Referee Confirming the Sale to Miller Was and Is Void and of No Force or Effect and Can Be Set Aside at Any Time.

Miller was an officer of the Court. The undisputed facts clearly show this, and the Court of Appeals so found in both its original opinion and in its opinion denying the petition for a rehearing. All the cases we have cited hereinabove clearly support this view.

The Referee, in his certificate on review, comments upon "Laches of Petitioners" [R. p. 9], and counsel for petitioner here strongly urges this point and the long delay "with consequent disturbance to land titles."

Counsel well knows that the petitioner, Paul Freedman, remained the owner of this entire property while the petition to set aside the sale was pending, and that he sold the property to Purdy during the pendency of the appeal in the Court of Appeals. It is therefore difficult to understand what disturbance to land titles counsel refers to.

The Court of Appeals, in its opinion denying a rehearing expressed in positive language its view of the "bona fide purchaser" contention. It then also had before it the petition of the Bank of America, containing photostats of the deed from the trustee to Miller; from Miller to Freedman and from Freedman to Purdy, each deed showing the amount of revenue stamps and indicating the purchase price in each instance, also the date when Freedman parted with title. Yet counsel, with full knowledge of these facts, urges upon this Court that there were no profits made and that there was a disturbance of title to the property.

Were such a sale not contrary to public policy and absolutely void under the law, then the question of failure

to file a timely review might play an important part in the determination of the rights of respondents in this proceeding. But where the law is enacted for the protection of the general public, a violation thereof is contrary to public policy and void, and even the consent of creditors and the Court would not validate the transaction.

A petition to set aside the order of a void sale is proper regardless of the fact that the time for a review had expired. Alleged equities do not control the question of public policy, neither can the question of laches be raised.

In an effort to defend the order of sale, the Referee attempts to show that the sale to Miller was the highest bid, and for the best interest of creditors, but just as the Court said in the case of *In re V. Loewer's Gambrinus Brewery Co.*, 167 F. 2d 318 at 319, that stockholders, because of a matter of public policy, will not be heard to deny unfairness, so in this case, because of the matter of public policy, no one can be heard to deny unfairness. The sale was and is void whether the Court approved or disapproved.

Furthermore, the petition to set aside the sale as void was in the nature of a petition for rehearing. The record discloses there was no objection to the hearing before the Referee upon the ground that the time for a review had expired or that there was any subsequent transfer which might involve a disturbance to land titles.

The limitation of time prescribed by Section 39c of the Bankruptcy Act is binding only on the litigants and not upon the Courts. Equity always has the power to set side fraudulent sales and fraudulent judgments. It was held

by this Honorable Court in *Pfister v. Northern Illinois Finance Corporation,* 317 U. S. 144, 63 S. Ct. 133 at 137:

> "Where a petition for rehearing of a referee's order is permitted to be filed, after the expiration of the time for a petition for review, and during the pendency of the bankruptcy proceedings, as here, they may be acted on, that is, they may be granted 'before rights have vested on the faith of its action,' and the foundations of the original order may be reexamined. Wayne United Gas Co. v. Owens-Illinois Glass Co., 300 U. S. 131, 137, 57 S. Ct. 382, 385, 81 L. Ed. 557. When such a petition for rehearing is granted and the issues of the original order are reexamined and an order is entered, either denying or allowing a change in the original order, the time for review under 39, sub. c, begins to run from that entry."

The California Supreme Court so appropriately said in *People v. Greene,* 74 Cal. 400 at 405:

> "A judgment which is void upon its face, and which requires only an inspection of the judgment roll to demonstrate its want of vitality, is a dead limb upon the judicial tree, which should be lopped off, if the power so to do exists. It can bear no fruit to the plaintiff, but is a constant menace to the defendant."

And later, this same Court said:

> "The power of a court to vacate a judgment or order void upon its face is not extinguished by lapse of time, but may be exercised whenever the matter is brought to the attention of the court. While a motion for such action on the part of the court is entirely appropriate, neither motion nor notice to an adverse party is essential. The court has full

power to take such action on its own motion and without any application on the part of any one. (Kriess v. Hotaling, 96 Cal. 617, 622.)"

People v. Davis, 143 Cal. 674, 675.

We respectfully submit that the Petition for a Writ of Certiorari does not present any reasons justifying the granting thereof, that it is without merit and should be denied.

Respectfully submitted,

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Of Counsel.